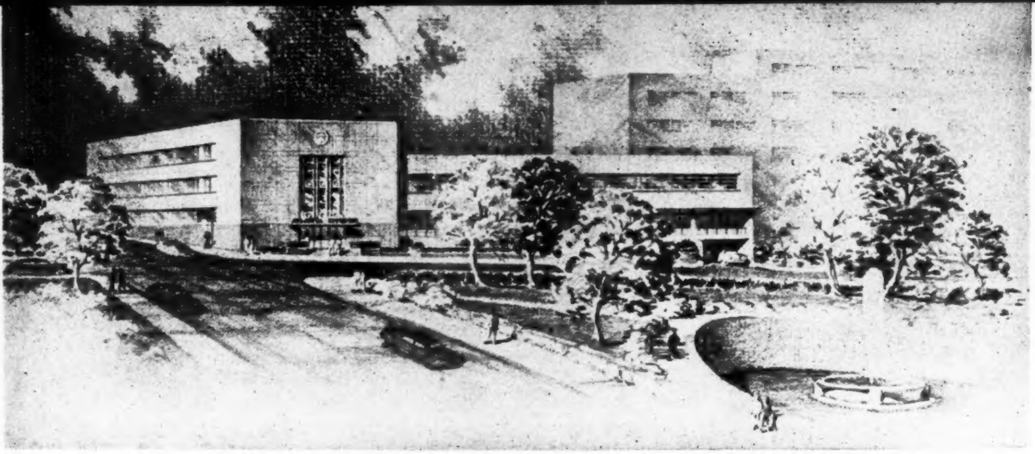

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COFFEE—WHY HIGH PRICES?

WILLIAM MILLARD*

Norcross, Ga.

INTRODUCTION

Coffee has been known and used for centuries. It was first reported in use in India and its use as a beverage slowly spread into Europe. At first the use of coffee met great resistance from the medical profession, which denounced it as harmful because of its mild stimulating characteristics. In spite of doctors' warnings, its use was almost universal among the higher classes by the early 18th century. Coffee is accepted today as a wholesome beverage, not in any way harmful to a healthy person. Its acceptance upon medical grounds is complete, with only a trace of handed down customs regarding its use by children. Coffee consumption has increased much faster than population, indicating both wider usage and an increase in per capita consumption, especially in recent years. The purpose of this paper is to follow the history of the production of coffee and its use. Special attention will be given to prices and the means of manipulating them.

PRODUCTION AND CONSUMPTION

Brazil is by far the largest coffee producing country in the world today, producing 52% of the total supply. Colombia, the second largest, produces 24%. All other growers are insignificant by comparison to these two. Coffee is grown in many parts of the world in small quantities but requires special climatic conditions for culture. Brazil has large areas of temperate, humid, and yet sub-tropical climate where the land is suitable for cultivation. Only about 44% of the total suitable acreage in Brazil has been utilized. Most of the Central and South American countries are coffee producers, as well as Cuba, Haiti, Puerto Rico, Africa, India, and many small islands and countries of similar climate. The coffee of each country is naturally differentiated by nature, producing a wide variety of flavors and aromas. Usually blends are formed from the product of several countries, enabling further differentiation of the product by the producers and roasters in the consuming countries. This has the disadvantage of making the roasters dependent upon smaller producers, but enhances the importance of these smaller, high cost firms. Nearly all blends use Brazilian coffee as a base.

Coffee has somewhat unique demand characteristics. Since the product is a stimulant it is therefore very mildly habit forming, making the consumer reluctant to discontinue its use. A drop in price, however, usually results in a large increase in both per capita and total consumption.[1] In spite of constantly rising prices, coffee consumption in the United States has increased over 1½ billion pounds in the last ten years. Estimates of the short run future consumption indicate a halt to the increase, at least temporarily, but little actual drop in consumption is expected.[2] Since Brazil produces 52% of the world's coffee and the United States consumes 64%, bargaining at the New York Coffee and Sugar Exchange usually sets the basic world price of coffee. Brazil exported 2.2 billion pounds in 1953, the United States imported 2.7 billion pounds, 1.8 billion pounds from Brazil. Per capita

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****Formerly a graduate student in Industrial Management at the Georgia Institute of Technology.***

The author wishes to express his gratitude to Dr. Walter S. Buckingham, Jr. of the Georgia Institute of Technology for reading this article and making helpful suggestions and criticisms. However, the author is responsible for all opinions expressed.

1 A check upon the actual demand, supply, and price figures indicates that the demand schedule for coffee is more elastic with rising prices than with decreasing prices, making a perfect theoretical possibility of forcing price up by the use of a continual price rise in combination with periodic cuts. Each time the demand falls off because of high prices, a price cut, smaller than the increment of rise made during the previous period, will restore the same number of consumers or more in spite of the improvement in price over the previous period. There is no indication that such a practice has been followed, however.

2 New York Times, January 31, 1954.

consumption in the United States has increased six fold since 1860.[3]

THE VALORIZATION OF COFFEE BY BRAZIL

Valorization means "to give value to." The word itself is not used in the United States, although perfect examples of practices that "give value to" products by artificial market manipulation are many. Some of these schemes are illegal in the United States (when engaged in by private businessmen) under the Sherman Act and other anti-trust legislation, but the government itself practices valorization by artificially raising the prices of some farm products with the parity plan, calling it simply "price supports."

In 1905, the state of San Paulo, Brazil, started the first coffee valorization scheme to head off a market glut and a price decline as the result of a record-breaking crop. The plan was very similar in many respects to the present plan followed by the United States concerning farm products. San Paulo not only restricted new plantings but also bought and warehoused large quantities of coffee. The stored coffee was then sold gradually during periods when its release would not affect prices. The state acted again in 1918 and 1921 in the same manner, using the same scheme. The valorization programs of San Paulo were independent of the Brazilian federal government until 1922, when the federal government passed the Permanent Coffee Defense Law, setting up a nation-wide system of warehouses and a finance program for regulating exports. Federal action was planned after the pattern of San Paulo's state-wide action. Valorization by the Brazilian government was practiced until 1931 when the plan collapsed with the onset of the depression. When world demand fell off, Brazilian warehouses bulged, and the government found itself financially unable to continue price supporting by buying coffee. Immediately a policy of destruction was adopted. Not only was surplus coffee burned as fuel for railroads and homes, but even the trees were destroyed to reduce production.

Valorization of coffee had little effect on prices, in spite of the fact that the Coffee Institute which administered the plan deliberately tried to set the price of Brazilian coffee to cover the highest cost producers in the country. Prices throughout the period from 1905 to 1940 never reached a level high enough to alleviate the ruinous conditions of the producers.

Cartelization of the coffee industry has been proposed at different times by the various producing countries, but never has any scheme been worked out. There are many reasons for this, but basically coffee is a staple farm commodity with too many growers. Attempts at cartelization have failed because of the inability of so many producers to come to terms as individual growers, and because many countries in which national control was impossible, were unable to contract definite terms on the international level. The wide differentiation of coffees, unstable supplies, and intense nationalistic sentiment are all factors which make an international coffee cartel uncertain and shaky, if not impossible.

Under the present system, high cost producers and low cost producers alike set prices as demand dictates, depending on the importance of each one's coffee in blends. Brazilian coffee is the cheapest, Brazil being the lowest cost producer. Attempts to control coffee prices have mainly been the result of overproduction from time to time. The five year time lag from planting to production causes growers to overplant in periods of high demand, causing in turn, periodic overproduction and underplanting. Total world production figures indicate a series of five to seven year cycles through World War II. Since demand was increasing at a relatively constant rate many attempts were made by governments, especially Brazil, to hold planting in check in order to eliminate overproduction.

The highest price reached under valorization was much lower than post war prices under heavy demand and free trade. Brazil dropped all efforts at valorization in 1937 and the price of coffee dropped

3 Figures from the U. S. Department of Commerce.

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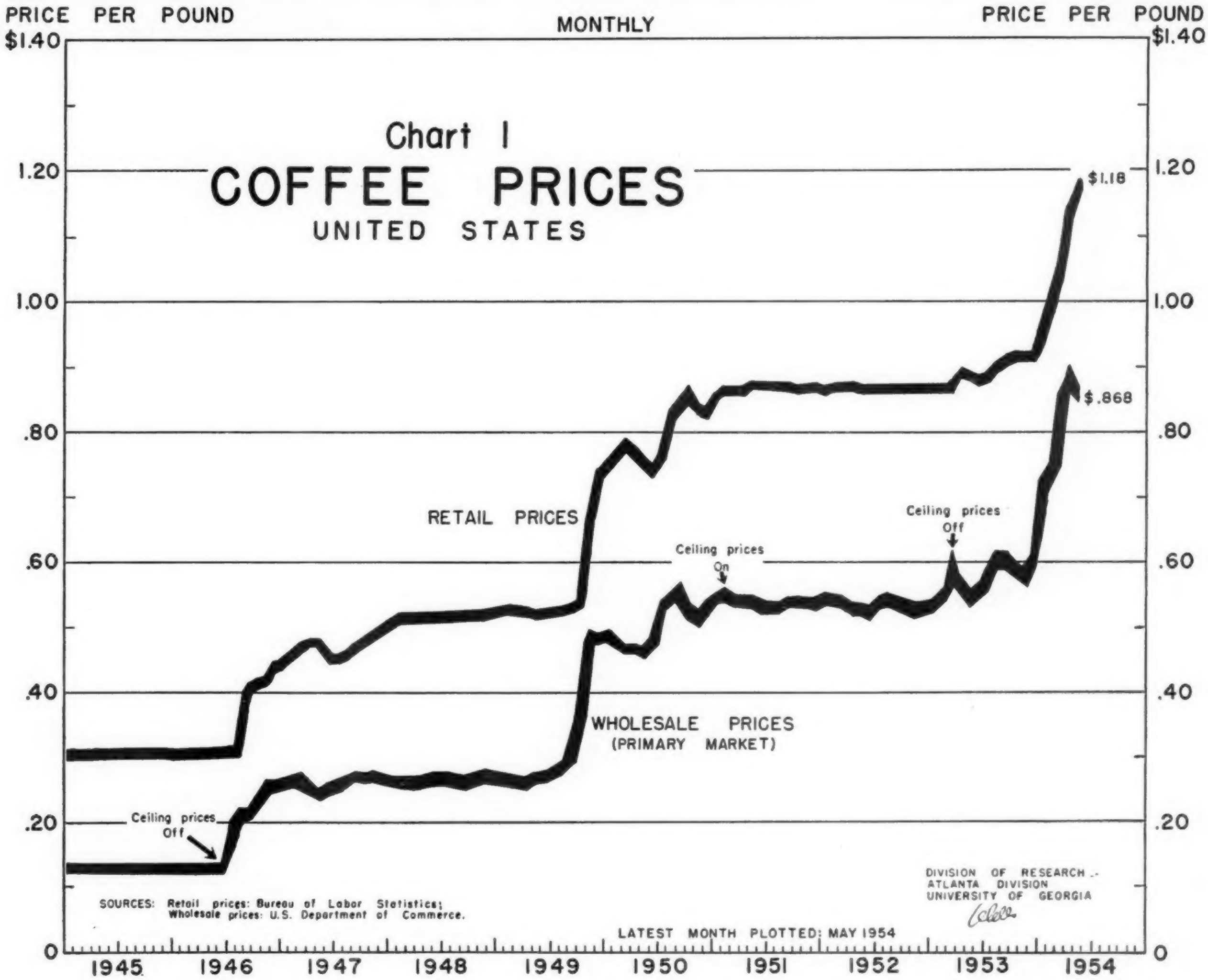
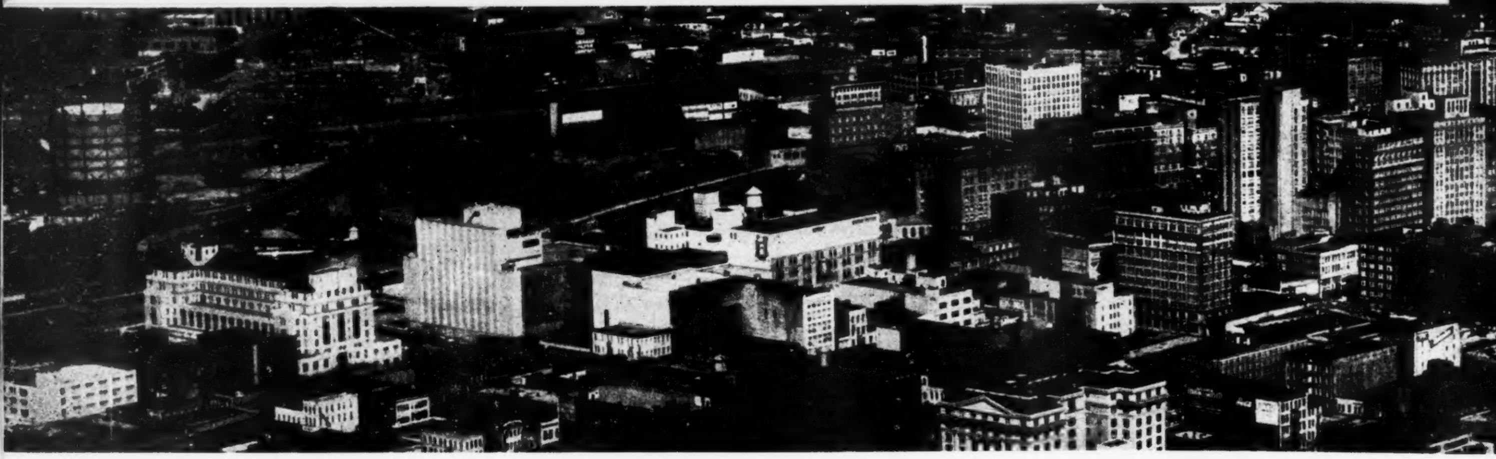


from 7½ cents (per pound) to a low of 6½ cents in early 1938. This was mainly due to the release of warehoused coffee into the world market by Brazil. Brazil actually prospered under the new policy in spite of the lower price, since the volume increased substantially. Ironically, Brazil has taken the brunt of the punishment with her valorization schemes. None of the other countries participated in the plan, but all benefited by Brazil's efforts. As a result Brazil burned millions of pounds of coffee and coffee trees during the 1930's because she refused to sell and other countries were supplying the market, leaving Brazil with a tremendous stockpile of surplus coffee that she could not market for fear of again lowering the price. During this period direct subsidies were given to the growers, even though the program virtuallly threatened the Brazilian government with bankruptcy. Today the Brazilian government does not actually buy and sell coffee, but it does provide credit and warehousing facilities and governs new plantings. This practice gives the planters protection from periodic market gluts caused by bumper crops. Since 1943, production has been consistently less than demand at given world prices, in spite of the Brazilian government's claims of vigorously encouraging new plantings. Production is still less than in 1937.

WARTIME QUOTA AGREEMENTS

In 1940, when the lowlands were invaded and France fell, the European coffee market was virtually wiped out and the Latin countries shipped their whole output to the United States. The result was a drop in price from 6½ cents per pound to 5⅜ cents in August, 1940. In November of that year all producing countries entered into a quota agreement with the United States.

The Pan American quota agreement was originally set up for a three year period, but was renewed to run through 1948. It was administered by the Inter-American Coffee Board which was made up of representatives from each producing country and the United States, the largest consumer. The



MAY
ATLANTA AREA ECONOMIC INDICATORS

ITEM	May 1954	April 1954	% Change	May 1953	% Change
EMPLOYMENT					
Job Insurance (Unemployment) Payments	$343,524	$378,775	–9.3	$138,382	48.2
Job Insurance Claimants†	5,644	5,255	7.4	2,550	121.3
Total Non-Agricultural Employment	296,400	297,550	–0.4	297,600	–0.4
Manufacturing Employment	78,150	78,600	–0.6	78,300	–0.2
Average Weekly Earnings, Factory Workers	$62.41	$61.86	0.9	$62.83	–0.7
Average Weekly Hours, Factory Workers	39.5	39.4	0.3	40.8	–3.2
Number Help Wanted Ads	7,236	6,961	4.0	12,401	–41.6
CONSTRUCTION					
Number Building Permits City of Atlanta	944	946	–0.2	977	–3.4
Value Building Permits City of Atlanta	$4,443,834	$6,583,267	–32.5	$5,269,106	–15.7
Employees in Contract Construction	16,050	15,700	2.2	15,150	5.9
FINANCIAL					
Bank Debits (Millions)	$1,226.8	$1,298.4	–5.5	$1,136.3	8.0
Total Deposits (Millions) (Last Wednesday)	$935.2	$941.7	–0.7	$919.0	1.8
POSTAL§					
Postal Receipts	$1,308,314	$1,429,437	–8.5	$1,157,736	13.0
Poundage 2nd Class Mail	1,346,501	1,462,489	–7.9	1,348,460	–0.1
OTHER					
Department Store Sales Index (Adjusted) (1947–49=100)	125	132	–5.3	143	–12.6
Department Store Stocks	N.A.	N.A.	–2.0	N.A.	–0.0
Retail Food Price Index (1947–49=100)	114.1	112.8	1.2	112.8	1.2
	(Mar. 54)	(Sep. 53)		(Mar. 53)	
Residential Rent Index	130.5**	129.1**	1.1**	128.0**	2.0**
Number Telephones in Service	247,277	246,436	0.3	236,420	4.6
Number Local Calls per Day	1,798,553	1,753,448	2.6	1,746,522	3.0

*Revised N.A.—Not Available.
§City of Atlanta only.

†Claimants include both the unemployed and those with job attachments, but working short hours.

**Index published for Atlanta semi-annually in March and September and appears in U. S. Department of Labor, Bureau of Labor Statistics publication "Construction.".

Sources: All data on employment, unemployment, hours, and earnings: Employment Security Agency, Georgia Department of Labor; Number Help Wanted Ads: Atlanta Newspapers, Inc.; Building permits data: Office of the Building Inspector, Atlanta, Georgia; Financial data: Board of Governors, Federal Reserve System; Postal data: Atlanta Post Office; Retail Food Price Index: U. S. Department of Labor; Department Store Sales and Stocks Indexes: Federal Reserve Bank of Atlanta and Board of Governors, Federal Reserve System; Telephones in Service: Southern Bell Telephone and Telegraph Company.

January Through May, 1953 and 1954

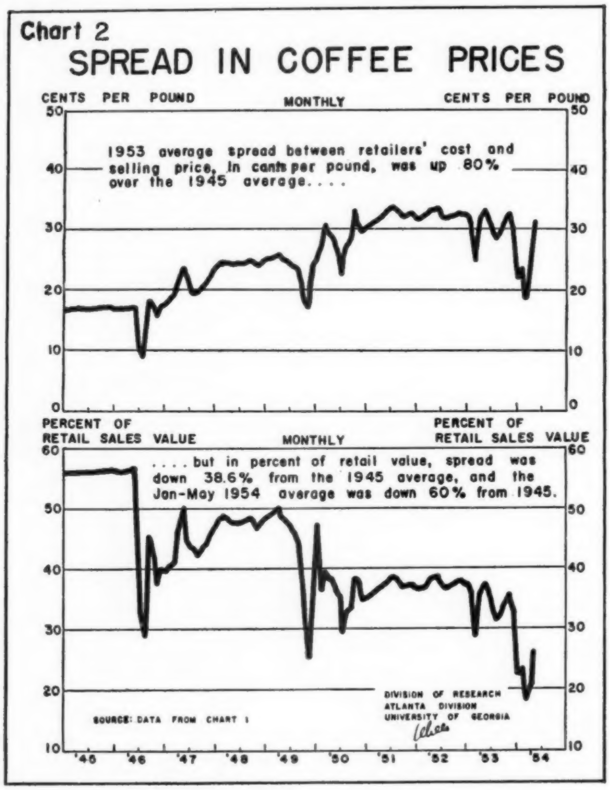
1954	1953	ITEM	PER CENT CHANGE
28,476	14,565	Job Insurance Claimants	+95.5
15,080	12,830	No. Construction Employees*	+17.5
$6,829,366	$5,910,177	Postal Receipts, Atlanta Post Office	+15.6
6,623,139	6,091,047	Poundage 2nd Class Mail Atlanta Post Office	+8.7
$6,255,245	$5,882,496	Bank Debits (Thousands)	+6.3
247,277	236,420	Telephones in Service**	+4.6
296,750	287,580	Total Non-Agricultural Employment*	+3.2
78,630	77,000	No. Manufacturing Employees*	+2.1
$935.2	$919.0	Total Deposits (Millions)**	+1.8
114.1	112.8	Retail Food Price Index (May)	+1.2
N.A.	N.A.	Department Store Stocks**	0.0
$62.35	$62.62	Average Weekly Earnings, Factory Workers*	−0.4
N.A.	N.A.	Department Store Sales Based on Dollar Amounts	−2.0
39.6	41.1	Average Weekly Hours, Factory Workers*	−3.7
4,326	4,778	Number of Building Permits City of Atlanta	−9.5
$23,679,934†	$27,764,498	Value Building Permits, City of Atlanta	−14.7
33,251	52,413	Number Help Wanted Ads	−36.6

†Special ruling permits construction of $20,500,000 Grady Hospital addition without permit. If included, total above is $44,179,934 and the change becomes plus 59.1%.
**End of period. *Average Month.
N/A—Not Available.
Sources: Same as page 4.

purpose of the agreement was to establish quotas from each country to the United States in an attempt to create an organized market. The agreement was in effect a direct guarantee from the United States inasmuch as the United States promised to buy from each country its established quota at a set price. As a result, prices immediately jumped to an average of 12 cents and remained at that level for three years. Due to transportation difficulties caused by the war (high insurance rates, shortage of ships, etc.) United States coffee stocks became very low in 1942 and 1943 and rationing went into effect. The Commodity Credit Corporation held prices to the consumer down by absorbing extra transportation costs for importers. Importers were allowed to sign their contracts to the C.C.C., which shipped the coffee to the United States and then sold it to the importer at the ceiling price. This plan was discontinued in 1943 when supply nearly equaled demand at the fixed price. After that extra costs were absorbed by the shippers. During this period price ceilings on coffee were successively dropped as the supply increased.

Under the quota agreements each country was assigned quotas, not on the basis of previous participation in the United States market (the only one then available), but rather on a basis which took into consideration, as one factor, total national production and the market restrictions facing each coffee producer as a result of the war. The agreement was dominated by the United States, which exercised 1/3 of the voting power. Any decrease in quotas (designed to increase price) required unanimous approval of all participating countries, including the United States. Increases in quotas required only a 2/3 vote. Thus the United States had the power to frustrate actions injurious to this country and promote beneficial action. The plan is unique because the consuming country dominated the action. It was considered an essential part of the United States' "good neighbor policy," and by guaranteeing a market for each country, prevented what might have been a far more acute post war shortage. Quota agreements were dropped in 1945 when for the first time in history demand at the South and Central American ports became substantially greater than supply; the situation has remained in that status to the present day, resulting in even higher prices.

In 1937 the Pan American Coffee Bureau was established for the purpose of advertising and promoting the use of coffee. The promotional schemes are administered by the Coffee Advertising Council consisting of members from each producing country. The Bureau spends nearly two million dollars yearly in the United States alone. It does not meddle in pricing; its work is solely that of keeping records and attempting to stimulate demand through advertising. The organization is financed by a tax levied on each country's exports at the rate of five cents per bag (132 lbs.). Nearly all producing



Spread as used in this chart is the difference between the average retail price and the average wholesale (primary market) price of Santos No. 4 green coffee. It includes cost of roasting, grinding, packaging, transportation, handling, advertising, etc., as well as profit, for all who handle the coffee from the time of the purchase of the green bean until it is sold by the retail grocer.

countries belong to the Bureau and contribute to its support.

THE PROBLEM TODAY—WHY HIGH PRICES?

During the 1930's Brazil destroyed over ten billion pounds of surplus coffee. Today the world is facing an acute coffee shortage. Prices for Brazilian coffee (wholesale) are about 80 cents per pound delivered to New York. In 1940 the price was 5⅜ cents. In 1942 Brazil had 5,372,000 acres under cultivation, exported 1,996,916,000 pounds having a value of $66,700,000. In 1946, Brazil had 5,921,000 acres under cultivation, exported 1,922,316,000 pounds having a value of $267,500,000. The United States imported 1,801,021,000 pounds in 1942, 2,475,929,000 pounds in 1946.[4] Considering the United States alone this indicates a four year increase in demand of 37% countered with only a 7% increase in supply. The net result was that coffee exported in 1946 was worth 4 times the value of coffee ex-

4 Figures from the U. S. Department of Commerce.

ported in 1942, on a pound for pound basis.[5] Today's price of 80 cents is 4.5 times higher than the 1946 price, 16 times the 1942 price.

In the period between 1946 and 1949 the spread between wholesale and retail prices went from 17.2 to 28 cents, evidence of an increased profit margin in the American roasting industry. As of recent times, however, both public opinion and demand considerations have forced the margin to remain steady and today it remains at about 30 cents as in 1949. In the meantime there is evidence that the growers are attempting to get a larger share of the coffee dollar, and green coffee prices have been rising sharply since 1949. The investigation started in 1953 by the United States government for the purpose of finding the cause of excessive coffee prices is still going on. So far nothing has been produced except occasional retorts from both importers and exporters. It is significant though that the government is meeting no resistance from either side in its inspection of records. Brazilian growers blame the expected rise to an all time high of $1.25 (retail) mainly upon the frost of July 4, 1953, which cut Brazil's crop by nearly 1/3. Also Brazilian authorities claim that exports have averaged 5% above production since 1945 and that warehouses are now nearly empty. The fact that Brazil has any warehoused coffee indicates that she has been holding back supplies, especially after over a ten year period of rising prices caused partially by a shortage of supply. There is doubt as to whether Brazil actually did drop valorization of coffee in 1937 as was formally announced.

The United States has voted limited CEA control over coffee trading as of February 11, 1953. No one expects this action to bring any price relief. Joseph C. Mehl, who heads the CEA, told the investigating committee that United States supervision would stop unwarranted boosts in price by policing effectively the trading in American markets, but agreed that his agency probably could do nothing about price fixing or production limits in any other country. C. A. Makey, president of a coffee importing firm, said more coffee production is needed and that regulation of the industry won't correct the situation.[6] The Brazilian public has this to say: "When the coffee prices fell so low that Brazil was burning it because nobody offered to buy it, that was considered supply and demand. Now coffee is short and we sell it for what is offered. What is wrong with that?"[7] The price is up in Brazil too. James S. Kemper, U. S. Ambassador to Brazil, says Brazilians are more upset about rising coffee prices than Americans. He says that the retail price in Brazil has risen 50% since last July and the cost of a cup of coffee has doubled in the last 90 days. The general belief is that the high prices will continue for at least 3 years, but in 4 years the bottom is expected to drop out of the market. This is because frostbitten areas will then be back in production as well as heavy new plantings. Most authorities agree that if the expected bumper crop of 1954 had escaped the frost, prices would have been on the decline already.

The outlook for price relief in the immediate future is dim, but the long run prospects for equitable coffee prices are very good if we assume Brazil's empty warehouses will stay empty. Probably coffee, under normal circumstances, will never again reach the low prices (in comparison with costs) for which it was marketed in 1940, mainly because it is generally agreed that the Brazilian and other governments will step in and control production and new plantings; but at the present time no government is either restricting new plantings or limiting exports. As long as coffee remains such a highly profitable commodity in a field of relatively free competition, the problem of supplying the world's needs requires only a matter of time. If, however, the governments of the producing countries interfere, as Brazil has done in the past, coffee prices are very apt to remain abnormally high.

5 Figures not corrected for inflationary trends.
6 The Atlanta Constitution, February 3, 1954.
7 New York Times, February 11, 1954.

SUMMARY

It is significant to note that today's high prices are caused by a true supply and demand situation arising from natural rather than artificial causes. The world generally is in a state of peak prosperity which has greatly increased the demand for coffee, especially in the European market. The heavy frost which destroyed a considerable part of Brazil's coffee crop July 4, 1953, has decreased the supply available for world consumption, causing the bidding to be intense and the price high. Past efforts of Brazil to raise coffee prices have no influence in determining the price of coffee today. Also increased profit margins to the roasters and packers in the United States add to the final price to the consumer. However, there is some indication that the packers are absorbing part of the extra wholesale cost to keep retail prices under the $1.25 a pound level in 1954. The charge is often made that Brazil is holding back supplies in order to get a higher price, but the total anticipated value of Brazil's 1954 coffee crop is expected to be less because of the reduced quantity which will be available. If this prediction is correct, Brazil certainly cannot be guilty of that course of action. Rather it seems that a once popular song is, for the present, out of style—there is not an awful lot of coffee in Brazil—not any more.

AVERAGE EARNINGS FOR SELECTED OCCUPATIONS IN ATLANTA ON DATES INDICATED

OCCUPATION	Atlanta Mar. 1952 Weekly Hours Standard	Atlanta Mar. 1952 Weekly Earnings Standard	Atlanta Mar. 1953 Weekly Hours Standard	Atlanta Mar. 1953 Weekly Earnings Standard	Atlanta Mar. 1954 Weekly Hours Standard	Atlanta Mar. 1954 Weekly Earnings Standard
Bookkeeping Machine Operators, Class B, men	39.0	$ 50.00	40.0	$ 49.00	39.5	$ 49.00
Bookkeeping Machine Operators, Class B, women	39.5	45.00	40.0	47.50	40.0	49.00
Clerks, Order, men	40.0	65.50	40.0	66.50	40.0	67.00
Clerks, Order, women	39.5	44.50	39.5	48.50	39.5	48.50
Clerks, Accounting, Class A, men	39.5	58.50	—	—	40.0	77.00
Clerks, Accounting, Class A, women	39.0	49.00	—	—	39.5	64.00
Clerks, File, Class A, women	39.5	46.50	39.5	55.00	39.5	53.50
Billing Machine Operators, women	40.0	45.50	40.0	51.00	40.0	52.50
Comptometer Operators, women	39.0	47.00	39.5	51.00	39.5	52.00
Secretaries, women	39.5	60.00	39.5	62.50	39.5	64.00
Stenographers, General, women	39.5	50.00	39.5	53.00	39.5	55.00
Tabulating-Machine Operators, men	39.5	60.50	39.5	60.50	39.5	64.00
Typists, Class A, women	39.5	46.00	39.5	50.50	39.5	51.00
Typists, Class B, women	39.0	38.50	39.5	40.50	39.5	43.00
Draftsmen, Leader, men	42.0	104.50	40.0	106.00	40.0	113.00
Draftsmen, Senior, men	40.0	76.00	40.0	78.00	39.5	86.50
Draftsmen, Junior, men	40.0	61.50	39.0	61.50	39.5	64.50
Nurses, Industrial, Registered, women	40.0	62.00	40.0	65.50	40.0	69.00
Truck Driver, Light (under 1½ T.) per hr.	$ .96		$ 1.09		$ 1.12	
Truck Driver, Heavy (over 4 T., trailer type) per hr.	1.21		1.35		1.39	
Laborers, Material Handling, per hr.	—		1.06		1.13	
Shipping Clerks, per hr.	1.25		1.35		1.46	
Watchmen, per hr.	.97		.98		1.01	
Carpenters, Maintenance, per hr.	1.70		1.82		1.89	
Electrician, Maintenance, per hr.	1.92		2.06		2.18	
Machinists, Maintenance, per hr.	1.79		1.94		2.05	
Mechanics, Automotive, Maintenance, per hr.	1.50		1.60		1.65	
Painters, Maintenance, per hr.	1.75		1.85		1.92	
Janitors, Porters and Cleaners, men, per hr.	.92		.99		1.04	
Janitors, Porters and Cleaners, women, per hr.	.53		.72		.73	

Source: U. S. Department of Labor, Bureau of Labor Statistics. Occupational Wage Surveys, Atlanta, Ga., March 1952, March 1953, March 1954.

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